ORIGINAL

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BEFORE THE ARIZONA CORPORATION COMMISSION

In the matter of:

RADICAL BUNNY, L.L.C., an Arizona limited liability company,

HORIZON PARTNERS, L.L.C., an Arizona limited liability company,

TOM HIRSCH (aka TOMAS N. HIRSCH)and DIANE ROSE HIRSCH, husband and wife;

BERTA FRIEDMAN. WALDER (aka BUNNY WALDER, a married person,

HOWARD EVAN WALDER, a married person,

HARISH PANNALAL SHAH and MADHAVI H. SHAH, husband and wife,

Respondents.

DOCKET NO. S-20660A-09-0107

MOTION FOR SUMMARY JUDGMENT OR TO DISMISS

(Oral Argument Requested)

Defendants hereby move to dismiss or for summary judgment on all claims related to securities fraud all as is more fully set forth in the attached Statement of Facts and Memorandum of Points and Authorities incorporated in this Motion.

RESPECTFULLY SUBMITTED this 19 day of April, 2010.

LAVELLE & LAVELLE, PLC

By: _____
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Memorandum of Points and Authorities

An Overview

As shown by the accompanying materials, Defendants did not sell anything. Defendants were members of a company that served as a buyer's agent to buy fractional interests in notes. Some were notes issued by the entity involved in construction projects and some were issued by Mortgages Ltd. to obtain funds to lend for construction projects. For the purpose of this Motion, those differences are an irrelevancy. All of the money raised was for construction, not financing for a business. The notes were for a fixed percentage amount, were not premised on someone else's profit and the purchases did not result from solicitations.

The Law

A. "Note" Does Not Mean Every Note.

The Securities statutes, both the Federal statutes and the State statutes, all define a security to include "any...note." Our state statute appears to be modeled on the Model State Securities Act. But in the arcane world of securities fraud, that is just the beginning of the inquiry. "The Supreme Court has often admonished that a "thing may be within the letter of the statute and yet not within the statute." United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 849 (1975)." Ruefenacht v. O'Halloran, 737 F.2d 320 (3d. Cir. 1984). This lawsuit is based on claims of fraud in the purchase or sale of securities. For the purposes of the fraud claims, the Federal law and the State law create the same tests for securities. The notes here do not meet the test.

The name given to the instrument does not determine if it is a security. For instance, in United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), the court considered "stock" in a cooperative. The court said "common sense suggests that people who intend to buy residential apartments in a state subsidized cooperative, for personal use are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called share of stock." See, 421 U.S. 849. The Supreme Court held that while the cooperative shares were called stock and "stock" was specifically listed in the definition of securities, cooperative shares do not equate to something ordinarily called stock.

What Radical Bunny sold, according to the Commission, (we deny Radical Bunny sold anything) was participations in a note not issued by Radical Bunny. These notes were for a fixed return of a non-contingent obligation. The seminal

case of SEC v. J.W. Howey Co., 328 U.S. 293 (1946), requires that an investment contract be "an investment of money in a common enterprise with profits to come solely from the efforts of others." See, 328 U.S. at 301. Using that reasoning, the court also held that employee's interest in a compulsory pension plan even though it had investments, had a return and was clearly designed to return money, was not a "security" within the meanings of the act. International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979).

The court noted that the employee did not invest in the pension fund, he only accepted employment. Here, the participant did not invest in Radical Bunny. Radical Bunny was the agent that acquired Mortgage Ltd. notes for its principals.

Before the law was changed to exempt certificates of deposits, Marine Bank v. Weaver, 455 U.S. 551 (1982), also held that such deposits were not securities. The 1934 Act specifically included the term "certificate of deposit," but the court noted that the securities laws were not intended to provide a broad remedy for all fraud.

B. The Participants Did Not Acquire An Interest In Radical Bunny.

Mortgages Ltd. had its own securities issues and registered many of their loans. The question for this Court is, was the participant buying into Radical Bunny? It clearly was not. So was what they bought a security?

C. These Notes Which Raised Funds For Construction Were Not Securities.

The characteristics usually associated with securities are the right to receive dividends contingent upon a portion of the profits, negotiability, the ability to be pledged or hypothecated, the conferring of voting rights in proportion to the number of shares owned and finally the capacity to depreciate in value. See,

Landreth Timber Co. v. Landreth, 471 U.S. 631 (1985). In that case, the court reserved until another day the question of whether notes or bonds might be shown by proving only the document itself. Five years later in Reeves v. Ernst & Young, 494 U.S. 56 (1990), the court said "that whether a note is a security depends on the nature of the note." Here the notes were used to finance construction. They were not generally thought of as a security.

D. There Was No Marketing.

As Vol. 2, Bromberg and Lowenfels, Securities Fraud and Commercial Fraud, (2009 ed.) states at ¶ 4:32 "one of the most important elements in determining whether or not a particular instrument is a security within the 1933 and 1934 Act definitions is a manner in which the interest is marketed. Here the notes were not marketed at all. There were no sales materials, no sales program, no solicitations, there was only word of mouth from other investors. See the Hirsch Declaration for a complete description of the program.

The Federal Securities Fraud law holds that notes may not be notes for securities fraud purposes. The cases are many. See, Kansas State Bank v. Citizens Bank, 737 F.2d 1490 (8th Cir. 1984), (participation in notes not subject to anti fraud provisions because it was collateralized, was at a fixed interest rate and the borrower intended to use the funds as operating funds). Chemical Bank v. Arthur Anderson & Co., 726 F.2d 930 (2nd Cir. 1984) (notes to finance a borrowers current operations were not securities even though their maturity may have exceeded nine months).

This analysis finally brings us to AMFAC Mortgage Corporation v. Arizona Mall of Tempe, Inc., 583 F.2d 426 (9th Cir. 1978). There the instruments were notes, and importantly suit was brought both under the Federal Securities Statutes

and the Arizona Statute. The court held a motion to dismiss appropriate. After noting that "It has been left to Federal courts to determine what financial transactions actually involve 'securities'." *Id.*, 583 F.2d at 431, and after noting a split in the circuits as to the tests used, the court reached this conclusion: "A note given to a lender in the course of a commercial financing transaction is not a security within the meaning of Federal Securities laws." *Id.*, 583 F.2d at 434. It finally concluded, "If we were to expand the reach of these acts to ordinary commercial loan transactions the purpose behind these laws would be distorted." *Id.*, 583 F.2d at 434.

So aside from the fact the Federal court dismissed a claim under the Arizona Securities law with that language, how do all these Federal cases impact Arizona? The Federal regulatory scheme resembles the Arizona Statutory scheme. (The various statutes, almost identical, are attached as Exhibits A, B and C). The courts have held our statute is derived from the Securities Act of 1933. Butler v. American Asphalt & Contracting Co., 25 Ariz. App. 26, 540 P.2d 757 (App. 1975). But most importantly, when the Arizona legislation enacted A.R.S §44-1999 as part of a series of amendments to Title 44, Chapter 12, it included the following statement of legislative intent:

> It is the intent of the legislature that in construing the provisions of Title 44, Chapter 12, Arizona Revised Statutes, the courts may use as a guide the interpretation given by the securities and exchange commission and the federal or other courts in construing substantially similar provisions in the federal securities laws of the United States.

Eastern Vanguard v. Arizona Corp. Comm'n, 206 Ariz. 399, 410, 79 P.3d 86 (2003).

Thus, Arizona looks to Federal interpretations of Securities law for guidance. First Citizens Federal Savings and Loan v. Worthen Bank and Trust, 919 F.2d 510 (9th Cir. 1990). Unless there is good reason from the Federal interpretation, Arizona will follow the Federal law, State v. Gunnison, 127 Ariz. 110, 618 P.2d 604 (1980). See also, Eastern Vanguard Forex, Ltd. v. Arizona Corp. Comm'n, 206 Ariz. 399, 79 P.3rd 86 (App. 2003), Nutek Information Systems, Inc. v. Ariz. Corp. Comm'n, 194 Ariz. 104, 977 P.2d 826 (App. 1998).

The Arizona courts had a perfect chance to disavow AMFAC when a criminal conviction was considered in State v. Tobler, 173 Ariz. 211, 841 P.2d 206 (1992), there a convicted appellant claimed the Arizona statute was unconstitutionally vague. For criminal purposes, the court held "notes" meant all notes, but it was careful not to extend its opinion to the interpretations Federal law might place on "notes" in civil actions for fraud. At footnote 5, it carefully noted "the issue of whether the Reeves test or something like it, is applicable to A.R.S. §44-1991 is not presented in this case." Tobler, 173 Ariz. at 213, footnote 5. It went on to say "we are not willing to mix and merge fraud with registration and ignore the plainly separate treatment accorded these concepts under both State and Federal law." Tobler, 173 Ariz. at 214. Thus, the law related to fraud is that notes intended to raise funds for construction projects are not securities under the fraud provisions of the State or Federal Securities Acts. A copy of the AMFAC decision is attached as Exhibit D.

Conclusion

These notes were given to a lender in the course of commercial financing transactions. Under the AMFAC decision reviewing both State and Federal law,

they were held not to be securities for the purposes of the fraud provisions of State and Federal law.

The fraud claims must be dismissed.

RESPECTFULLY SUBMITTED this 29 day of April, 2010.

LAVELLE & LAVELLE, PLC

By: _____

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ORIGINAL and 13 COPIES filed this 29 day of April, 2010 with:

ARIZONA CORPORATION COMMISSION
Securities Division
1300 West Washington, Third Floor
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COPY of the foregoing MAILED this 29 day of April, 2010 to:

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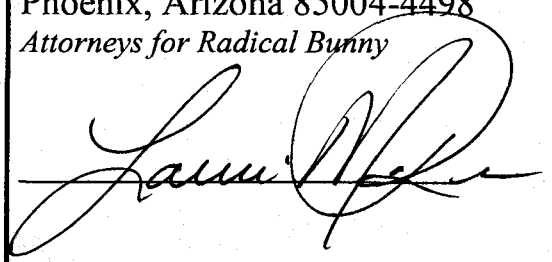

EXHIBIT A

§ 2(1)(a) of the Securities Act of 1933 (formerly § 2(1) of the Securities Act of 1933) defines the term "security" as follows:

Sec. 2(a) Definitions—. When used in this title, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

EXHIBIT B

§ 3(a)(10) of the Securities Exchange Act of 1934 defines "security" in substantially similar terms:

> Sec. 3.(a) When used in this title, unless the context otherwise requires—
>
> . . .
>
> (10) The term "security" means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

EXHIBIT C

26. "Security" means any note, stock, treasury stock, bond, commodity investment contract, commodity option, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, viatical or life settlement investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, real property investment contract or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

EXHIBIT D

LEXSEE 583 F.2D 426

AMFAC MORTGAGE CORPORATION, an Oregon Corporation, Plaintiff-Appellant, v. ARIZONA MALL OF TEMPE, INC., a Minnesota Corporation, Watson, Frederick O., and Watson, Jane Doe, his wife, Ericson, Orrin A., and Ericson, Galoris A., his wife, Watson Construction Company, a Minnesota Corporation, Commercial Union Insurance Company, a Massachusetts Corporation, the Ericson Development Co., a Minnesota Corporation, Defendants-Appellees.

No. 76-1495

UNITED STATES COURT OF APPEALS, NINTH CIRCUIT

583 F.2d 426; 1978 U.S. App. LEXIS 8679; Fed. Sec. L. Rep. (CCH) P96,588

October 3, 1978

PRIOR HISTORY: [**1] Appeal from the United States District Court for the District of Arizona.

COUNSEL: William S. Hawgood, II (argued), Phoenix, Ariz., for plaintiff-appellant.

Joseph E. McGarry, Phoenix, Ariz., P. Michael Whipple (argued), Phoenix, Ariz., Frederick J. Martone (argued), of Jennings, Strouss & Salmon, Phoenix, Ariz., David L. White (argued), Phoenix, Ariz., for defendants-appellees.

JUDGES: Before WALLACE and ANDERSON, Circuit Judges, and WILLIAMS, * District Judge.

* The Honorable David W. Williams, United States District Judge for the Central District of California, sitting by designation.

OPINION BY: ANDERSON

OPINION

[*428] This is yet another attempt to convert the securities laws into something which they are not. The securities laws do not afford general relief when commercial loans turn out to have been unwisely made, nor are they a source of general federal jurisdiction. See *Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1253 (9th Cir. 1976)*. Arizona Mall of Tempe, Inc. (Arizona Mall) defaulted on a building loan agreement with Amfac Mortgage Corporation (Amfac). Amfac brought suit in Arizona state courts on the secured promissory note which [**2] had been given by Arizona Mall. Amfac then instituted this action in the federal district court in Arizona, arguing that the promissory note was a "security" within the meaning of the federal and Arizona securities laws. [1] The district court dismissed all of Amfac's securities claims for failure to state claims upon which relief may be granted. The district court also dismissed Amfac's eighth claim for relief which involved a tort against a surety for failure to state a claim upon which relief may be granted.

1 Second claim alleged violation of § 10(b) of the Exchange Act and Rule 10(b)5. Third claim alleged violation of *§ 12(2)* and § 17 of the Securities Act. Fourth claim alleged violation of § 44-1991 of the Arizona securities law. Fifth claim alleged violation of § 15 of the Securities Act and § 20 of the Exchange Act. Sixth claim alleged conspiracy to violate the Securities Act and the Exchange Act. Seventh claim alleged further violations of *§ 12(2)* and § 17 of the Securities Act, § 10(b) and Rule 10(b)5 of the Exchange Act, and § 44-1991 of the Arizona securities law.

[**3] We affirm.

FACTS

This case arises out of the transactions which were undertaken to finance the construction of a shopping center. The principal actors involved in those transactions include the parties to this appeal. Appellant Am-

fac was the lender who undertook the financing of the project. Appellee Arizona Mall was the owner and borrower from Amfac. Appellee Orrin Ericson was the president of Arizona Mall and also of Appellee Ericson Development Company. Appellee Watson Construction Company (Watson Construction) was the contractor for the construction of the shopping center, and Appellee Frederick O. Watson was the president of that company. Appellee Commercial Union Insurance Company (Commercial Union) was the surety on the construction bond under which Watson Construction was the principal, and Amfac and Arizona Mall were the obligees.

On July 11, 1973, Arizona Mall entered into a construction contract with Watson Construction by which Watson obligated itself to construct the shopping center. On that same day, a surety bond was secured from Commercial Union whereby Commercial Union, as surety, bound itself to protect Amfac and Arizona Mall as dual obligees, in the event [**4] of default by Watson Construction, the principal.

After reviewing the construction contract documents and receiving further assurances from Watson Construction, Amfac formally committed itself to the transaction on August 27, 1973, when the promissory note, deed of trust, and building loan agreement were executed. The promissory note had a face amount of 22.5 million. The entire principal sum under the note was payable [*429] by Arizona Mall to Amfac within two years. Arizona Mall could obtain an extension of one year providing it was not in default and upon payment of an additional $ 225,000.00. Interest on the money actually disbursed under the building loan agreement was to be paid monthly to Amfac. The interest rate was determined monthly at a rate of either 4% Or 51/2% Over the prime interest rate. In the event of default by Arizona Mall under the building loan agreement or deed of trust Amfac could accelerate and demand payment of all sums (both principal and interest) outstanding on the note. To secure payment on the note, Amfac was designated as the beneficiary under a deed of trust to the real property and the shopping center itself as it was completed.

Under [**5] the building loan agreement, Amfac was to make periodic advances of the principal amount of the promissory note depending upon the degree of completion of the shopping center and whether certain designated lease commitments had been obtained. Amfac's loan was further protected by various other provisions of the building loan agreement. There could be no changes in the plans of specifications which would change the square footage of the project or reduce or increase the contract price by $ 500.00 or more without the prior written approval of Amfac. The prior approval of Amfac was necessary before anything could be purchased for the shopping center under a conditional sales contract or security agreement. Amfac had the right to inspect both the project and Arizona Mall's books and records. A provision protected Amfac's interest from any lien claims. The events of default were spelled out in some detail.

Amfac's interest was additionally secured by other collateral which was pledged by Appellee Ericson and his wife. This included Ericson's interest in the following partnerships: Camelback Center, Conestoga Mall of Grand Island, Northern Center, Park Drive Shopping Center, and [**6] Valley West DM. Ericson also pledged 250 shares of the common capital stock of Ericson Development and his wife pledged 225 shares of the common capital stock of Village Ten, Inc. The Ericson appellees also signed a guaranty whereby they obligated themselves to pay all of the obligations of Arizona Mall. Amfac had the power under the guaranty to proceed against the Ericsons and their collateral regardless of what action was taken against Arizona Mall. Additionally, the Ericsons signed a guaranty of completion under which they agreed to assume all responsibility for completion of the project in the case of abandonment by Arizona Mall. Any indebtedness of Arizona Mall to the Ericsons was subordinated to the indebtedness and obligations of Arizona Mall to Amfac.

Amfac alleges that the promissory note issued by Arizona Mall was a security, and also that the guaranty, and completion guaranty, were each "securities." Additionally, Amfac claims that all of the documents involved in the transactions taken together were an investment contract and therefore a "security" under the securities laws.

DISMISSAL UNDER *RULE 12(b)(6)*

The test for determining the sufficiency of the plaintiff's [**7] complaint under *Rule 12(b)(6), Fed.R.Civ.P.*, motion for dismissal is:

> ". . . (A) complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."

Conley v. Gibson, 355 U.S. 41, 45-46, 78 S. Ct. 99, 102, 2 L. Ed. 2d 80 (1957), and *Harmsen v. Smith, 542 F.2d 496, 502 (9th Cir. 1976)*. In this case, the court is aided in its determination by the attachment of several documents to the plaintiff's complaint. [2] The court is not limited by the mere allegations contained in the complaint as Amfac contends. These documents, as part of the complaint, are properly a part of the court's [*430]

review as to whether plaintiff can prove any set of facts in support of its claim that there were securities involved in the present transaction. On a motion to dismiss, the complaint is construed in favor of the pleader. *Sherman v. Yakahi, 549 F.2d 1287, 1290 (9th Cir. 1977).* And any doubts are resolved in favor of the pleader. *Williams v. Gorton, 529 F.2d 668, 672 (9th Cir. 1976).*

2 See *Tenopir v. State Farm Mut. Co., 403 F.2d 533 (9th Cir. 1968)*, where court considered insurance policy attached to the complaint in a motion to dismiss for failure to state a claim.

[**8] Amfac argues that dismissal for failure to state a claim was improper in this case in view of *Great Western Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976).* In Great Western, which also presented the question of whether a security was involved, the court held that a dismissal under *Rule 12(b)(6)* was improper. However, the summary disposition was upheld because the court treated it as a motion for summary judgment. However, Great Western is distinguishable on this point from the present case. In Great Western, the district court considered evidentiary matter beyond the plaintiff's complaint. [3] Unless this evidentiary matter was incorporated in the plaintiff's complaint, it could not usually be considered by the court on a motion to dismiss for failure to state a claim. [4] Therefore, if any state of facts, even those inconsistent with the evidentiary matter presented to the court, could have supported the allegations of plaintiff's complaint, then dismissal was erroneous. However, in the present case this court is not so limited. Since the plaintiff attached to the complaint the several basic documents, the scope of the facts which can support plaintiff's claim [**9] is limited by the documents attached to the complaint and involved in this transaction. In the present case, dismissal would be improper only if under any state of facts supporting the allegations of plaintiff's complaint And the attached documents, plaintiff has stated a valid claim.

3 In the present case, matters outside the pleadings were offered to the district court in the form of an affidavit from appellee Ericson. However, this has no bearing on this motion for two reasons: First, it can be presumed that the district court did not use the affidavit in arriving at its decision to dismiss. The district court must have impliedly excluded the affidavit since it characterized its decision as a motion to dismiss for failure to state a claim rather than as a motion for summary judgment. And, secondly, the affidavit contains little of substance, and nothing which was needed by this court or impliedly by the district court, to arrive at a decision.

4 Under *Fed.R.Civ.P. 12(b)*, when "matters outside the pleading are presented to and not excluded by the court" the motion to dismiss for failure to state a claim (12(b)(6)) "shall be treated as one for summary judgment."

[**10] Additionally, Amfac contends that it is improper to decide the issue of whether there is a security on a motion to dismiss for failure to state a claim. However, if the transactions pleaded in plaintiff's complaint do not constitute "securities," then dismissal for failure to state a claim upon which relief can be granted is proper. *Hilgeman v. National Insurance Co. of America, 547 F.2d 298, 300 (5th Cir. 1977).* [5]

5 On the record made here dismissal in this instance is also proper under *Fed.R.Civ.P. 12(b)(1)* for lack of subject matter jurisdiction. See the procedural history of United Housing Foundation v. Forman (Forman v. Community Services, Inc.), *366 F. Supp. 1117 (S.D.N.Y.1973), 500 F.2d 1246 (2nd Cir. 1974), 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975).* This defense may be asserted at any time, at either the trial or appellate level, by either the parties or by the court. 5 Wright & Miller, Fed.Prac. & Pr. 545 (1969). Other Circuits have held that dismissal for lack of subject matter jurisdiction was proper in litigation under the securities laws after a determination that promissory notes were not securities. *C. N. S. Enterprises, Inc. v. G. & G. Enterprises, Inc., 508 F.2d 1354 (7th Cir. 1975)*, Cert. denied, *423 U.S. 825, 96 S. Ct. 38, 46 L. Ed. 2d 40 (1975); McClure v. First National Bank of Lubbock, 497 F.2d 490 (5th Cir. 1974)*, Cert. denied, *420 U.S. 930, 95 S. Ct. 1132, 43 L. Ed. 2d 402 (1975); Lino v. City Investing Co., 487 F.2d 689 (3rd Cir. 1973)*; See also *McGovern Plaza Joint Venture v. First of Denver Mortgage Investors, 562 F.2d 645 (10th Cir. 1977)* (dismissal proper after finding that no security was involved in the transaction; however, the exact basis under *Rule 12* is unclear). The record here enabled the district court to properly rule as a matter of law either that no claim for relief could be stated (as it did) or that there was no federal subject matter jurisdiction.

Alternatively, on this record, it could be treated as a motion for summary judgment as was done in *Great Western, supra.* Nevertheless, we are persuaded that our textual analysis is the correct approach on this record.

[**11] [*431] THE SECURITY ISSUE

The term "security" is defined broadly under both the Securities Act of 1933 and the Securities Exchange Act of 1934. The Exchange Act provides that:

> ". . . unless the context otherwise requires
>
> (10) The term "security' means any note . . . investment contract . . . or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing . . . ."

15 U.S.C. § 78c(a)(10). Even though the definition in the Securities Act of 1933 is slightly different, the two definitions have been held to be virtually identical. *Tcherepnin v. Knight, 389 U.S. 332, 335-336, 88 S. Ct. 548, 19 L. Ed. 2d 564 (1967)*; *United California Bank v. THC Financial Corp., 557 F.2d 1351, 1356 (9th Cir. 1977)*; *Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1255 (9th Cir. 1976).* The definition of security under the Arizona securities law (*Ariz.Rev.Stat. § 44-1801, et seq.*) is also similar and has been held to be virtually identical to the definition under the federal securities law. *State v. Brewer, 26 Ariz.App. 408, 549 P.2d 188, 195 (1976)*; [**12] And see *Hall v. Security Planning Service, Inc., 371 F. Supp. 7, 14 (D.C.1974).* The analysis of whether a security was involved in this transaction is equally applicable to the question as presented under Arizona law and under both of the federal statutes.

It has been ultimately left up to the federal courts to determine what financial transactions actually involve "securities" so as to come within the coverage of these statutes. *United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 848, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975).* There is a split between different circuits in the analysis that is utilized in defining "securities"; however, the importance of this is minimal since the results that are reached are generally consistent. [6]

> 6 The Ninth Circuit uses a risk capital test in determining whether a transaction is a security. This approach is followed in this decision where we find that the transaction involved did not involve securities under the Federal securities laws. The Second Circuit employed a literal approach in defining security in a recent case. And the Third, Fifth, Seventh, and Tenth Circuits generally follow an "investment-commercial" test.
>
> The literal approach of the Second Circuit was advocated by Judge Friendly in *Exchange National Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976).* Judge Friendly said that all "notes" should be considered securities under the securities laws, unless the note bears "a strong family resemblance" to an enumerated list where the context of the transaction required an exception. Despite the fact that this list focuses on smaller transactions, a note given to finance construction as is involved in the present case, should at least qualify as a relative to Judge Friendly's list of exceptions so that it would not be a security under the securities laws.
>
> The "investment-commercial" test is premised on the view that the securities laws evinced the concern of Congress about practices associated with investment transactions, and that the securities laws were not designed to regulate commercial transactions. Different characteristics are considered in determining the investment or commercial nature of different notes. See, e.g., *McGovern Plaza Joint Venture v. First of Denver, 562 F.2d 645 (10th Cir. 1977)*; *C. N. S. Enterprises, Inc. v. G. & G. Enterprises, Inc., 508 F.2d 1354 (7th Cir. 1975)*, Cert. denied, *423 U.S. 825, 96 S. Ct. 38, 46 L. Ed. 2d 40 (1975)*; *McClure v. First National Bank of Lubbock, 497 F.2d 490 (5th Cir. 1974)*, Cert. denied, *420 U.S. 930, 95 S. Ct. 1132, 43 L. Ed. 2d 402 (1975)*; *Lino v. City Investing Co., 487 F.2d 689 (3rd Cir. 1973).*
>
> A decision applying the investment-commercial test to a factual situation similar to the present case is *McGovern Plaza Joint Venture v. First of Denver, 562 F.2d 645 (10th Cir. 1977)*, where the plaintiff sought financing for the construction of a hotel. The defendants gave a construction loan commitment, and a permanent loan commitment to the plaintiff by which the construction was to be financed. After the defendants failed to carry out their loan commitments, the plaintiff brought an action alleging violation of the securities laws. The district court dismissed the action because the transaction was not a security. The Tenth Circuit affirmed the dismissal after finding that the construction financing was not a security under the commercial investment test. In conclusion, the court said: "(i)n short, there is nothing to indicate that this is anything other than the typical situation where a real estate developer goes into the open market to secure financing for his venture." *Id. at 647.* This same rationale is equally applicable to the present case.

[**13] Whether the promissory note and other documents given to Amfac constituted [*432] "securities" within the meaning of the securities laws must be analyzed under this circuit's "risk capital" test. Under this test the ultimate inquiry is whether Amfac "contributed "risk capital' subject to the "entrepreneurial or managerial efforts' of (others)." *United California Bank v. THC Financial Corp., 557 F.2d 1351, 1358 (9th Cir. 1977)*; *Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1257 (9th Cir. 1976)*. This approach encompasses the economic realities standard and the Howey [7] test which have been utilized by the Supreme Court in *United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975). United California Bank v. THC Financial Corp., 557 F.2d 1351, 1358 (9th Cir. 1977).*

7 *S. E. C. v. Howey Co., 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946).*

Six factors were considered in Great Western And United [**14] California Bank to measure the risk involved to the lender. These are not exclusive, nor is any single one dispositive. The factors used were:

(1) time,

(2) collateralization,

(3) form of the obligation,

(4) circumstances of issuance,

(5) relationship between the amount borrowed and the size of the borrower's business, and

(6) the contemplated use of the funds.

Even though these factors may be analyzed individually, it is their combined effect which is important. They should not be applied blindly. They must be considered within the context of the securities laws and their purpose. The securities laws were designed to provide for the disclosure of information to those who invested risk capital and to protect them from fraud. [8] With these considerations in mind, we now turn to the ultimate question of whether Amfac contributed capital which was subject to the risk of the entrepreneurial or managerial efforts of Arizona Mall.

8 In *United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 95 S. Ct. 2051, 2059, 44 L. Ed. 2d 621 (1975)*, the Supreme Court stated:

"The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors."

[**15] Two of the Great Western factors may support Amfac's construction of the note as a security: The relationship between the amount borrowed and the size of the borrower's business, and the contemplated use of the proceeds. The risk to the lender increases in proportion to the amount that is borrowed in relation to the size of the borrower's business. The risk to the lender also increases in proportion to the degree to which his funds are necessary to the formation of the enterprise. Since none of the attached documents shed any light on these factors, they will be resolved in favor of Amfac and it will be assumed for purposes of this decision that Amfac could present facts to support its position on these two factors. Nonetheless, this is far from being determinative on the issue since Amfac took several steps to protect itself from any risk which may have been created by these factors.

As a general rule, the longer one's money is held by another, the greater the risk of loss becomes for the one contributing the money. Under the terms of the various agreements, Amfac's money was not at risk for a long period of time. The promissory note was due and payable twenty-four months [**16] after the date of execution of the note. However, the disbursements by Amfac under the note were dependent upon the progress of construction and the assurances of lease commitments. Only a portion of Amfac's money was actually at risk for the entire twenty-four month period, with the remainder at risk for shorter periods, which were dependent upon the degree to which Amfac's risk was secured by the lease commitments and completion of the construction. Moreover, it was within the exclusive control of Amfac to cease loan disbursements for a variety of reasons, thus giving it the power to reduce the overall risk. In the event of default, Amfac was [*433] entitled to accelerate under the agreement and demand immediate payment of principal and interest (which eventually Amfac did). These considerations taken together support our finding that Amfac's money was not at risk with Arizona Mall for any substantial length of time.

If a lender is unsecured, then repayment of the loan is more dependent upon the managerial or entrepreneurial efforts of the borrower. If the loan is secured, then the lender is not as dependent since he can always look to the collateral in the event of nonpayment. [**17] There is a greater risk created with unsecured loans than with secured loans. Amfac was a secured lender. The loan was secured by the shopping center itself. Amfac's disbursements were timed and conditioned upon the completion of the shopping center and the procurement of lease commitments. Obviously, the intention of Amfac was to have its loan secured to the extent of its disbursements. Additionally, Amfac was secured by the additional collateral put up by the Ericsons and by their guarantees. This certainly made Amfac's loan more secured than the lenders were in either the Great Western or United California Bank cases. In Great Western, the lender was unsecured except for the requirement that the borrower maintain a minimum balance. And the lender in United California Bank only held a security interest in the accounts receivable of the borrower.

The form of the obligation supports appellees' position that a commercial loan was involved here and not an investment of risk capital. [9] Throughout the documents attached to plaintiff's complaint, Amfac is referred to as lender and Arizona Mall is referred to as the borrower. There is the promissory note, the building loan agreement, [**18] the construction contract, and the guarantees. Nowhere is there any indication that the parties were dealing with securities, or that they believed that the securities laws would govern the transaction. [10] All of the documents taken together lead to the inescapable conclusion that this was a typical construction financing transaction and not the sale of a "security" or "securities."

9 In *United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975)*, the Supreme Court held that the name given to an instrument is not dispositive as to whether it is a security, but went on to say that the name may be a factor in deciding whether an instrument is a security for the purpose of applying the federal securities laws. *Id. at 850, 95 S. Ct. 2051.* The Court said that it may be important because the parties may believe that the transaction is covered by the securities laws when the instruments involved are characterized in the manner whereby the securities laws usually come into play. The form and characterization of the building loan agreement and promissory note in the present case would certainly not give rise to any reasonable expectation by Amfac that the transaction would be covered by the securities laws.

[**19]

10 Securities are partially involved in the additional collateral which was pledged by the Ericsons. However, in terms of the whole transaction, this was of minor significance.

The circumstances surrounding the issuance of the promissory note similarly cannot support a finding that Amfac was placing its money at the risk of the entrepreneurial or managerial efforts of the appellees. Amfac as the lender negotiated the transaction with Arizona Mall and the other appellees. Amfac admits that all relevant information was made available to them. The building loan agreement prohibited any further borrowing by Arizona Mall. Arizona Mall could not and did not offer the promissory note or any other promissory notes to anyone else, and so it was not part of any type of public offering.

Amfac argues that 90% Of the promissory note from Arizona Mall was held by other real estate investment trusts. In view of the circumstances surrounding the transaction, this factor is not given too much weight. Interests in the note were not offered to the public at large. Amfac had the opportunity to inspect [**20] all of the relevant information surrounding the project prior to entering into it. Amfac was a sophisticated lender. Furthermore, Amfac had the continuing right to inspect the project and the books and records of Arizona Mall at any time. Moreover, the United California Bank decision suggests that the [*434] promissory note should be analyzed separately from any participation interests in it.

> "(W)hile the underlying note may not be a security, the participation interest may fall within the definition of a security. Cf. *Avenue State Bank v. Tourtelot, 379 F. Supp. 250, 254 (N.D.Ill.1974).*"

557 F.2d at 1357, fn. 8. In the present case, the sole lender is bringing an action against the borrowers under the promissory note. Even if Amfac is bringing the action on behalf of those to whom It Sold participation interests, the facts surrounding those separate transactions are not before the court, nor do they need to be to arrive at a decision in the present case.

Other factors further dispel the idea that Amfac was placing its money at risk subject to the entrepreneurial or managerial skills of Arizona Mall. Interest on the amount disbursed [**21] was to be paid monthly to Amfac. Neither the payment of principal nor interest was conditioned upon the success of the shopping center. The entire principal amount of the promissory note was due and payable twenty-four months after the note was

executed. An acceleration clause is not a typical characteristic of a security, nor are specific events of default.

The United California Bank decision considered the fact that the notes involved there carried an interest rate 2.75% Over commercial prime as an additional factor indicating that a commercial lending situation was contemplated rather than an investment of risk capital. *557 F.2d at 1358.* The promissory note to Amfac carried an interest rate of 4% Or 51/2% Over commercial prime which is also more indicative of a commercial lending situation than an investment of risk capital.

The "economic realities" of this transaction all lead to the conclusion that the promissory note given to Amfac was not a security. Amfac was not making an investment of risk capital subject to the managerial or entrepreneurial efforts of Arizona Mall. Amfac was making a construction loan to finance a shopping center. A note given to a lender [**22] in the course of a commercial financing transaction is not a security within the meaning of the federal securities laws. If we were to "expand the reach of those acts to ordinary commercial loan transactions," the purpose behind those laws would be distorted. *Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1260 (9th Cir. 1976).*

After reviewing this transaction as set forth in Amfac's complaint in the light most favorable to it, and resolving any doubts in favor of Amfac, we conclude that the complaint does not state a claim upon which relief could be granted under the securities laws. The district court's dismissal of the second, third, fourth, fifth, sixth and seventh claims of Amfac's complaint is therefore affirmed.

TORT ACTION AGAINST A SURETY

Amfac's eighth claim for relief alleged that Appellee Commercial Union had breached a duty owed to Amfac as an obligee under the construction surety bond. The district court dismissed this claim for failure to state a claim upon which relief may be granted to the extent that the eighth claim stated claims for breach of fiduciary or any implied duty. The district court granted Amfac leave to amend the eighth claim to [**23] assert any contract claim against Commercial Union.

On appeal, Amfac argues that a surety on a bond owes an implied duty of good faith to the obligee of the bond, and that a breach occurs when the surety fails to settle, thus giving rise to an action in tort.

Jurisdiction of this claim is based on diversity of the parties. *28 U.S.C. § 1332(a).* Amfac is an Oregon corporation with its principal place of business in California. Commercial Union is a Massachusetts corporation with its principal place of business in Massachusetts. Under the Erie doctrine, the federal court sitting in a diversity action is required to apply state law to questions of substantive law. In this case, the law of Arizona must be examined to determine whether Amfac stated a claim upon which relief could be granted. None of the parties have been able to point to any Arizona law which directly confronts the issue before the court. In this situation a [*435] federal court must use its own best judgment in predicting what the Arizona Supreme Court would decide in this case. *Tavernier v. Weyerhaeuser Company, 309 F.2d 87 (9th Cir. 1962).*

In a case involving a [**24] surety's duties towards his principal, an Arizona decision imposed the obligation of acting in good faith on the surety. *Cushman v. National Surety Corp. of New York, 4 Ariz.App. 24, 417 P.2d 537, 540 (1966).* However, the surety's liability was strictly limited by the terms of his contract. Id. This indicates that the Arizona courts would not imply a cause of action in tort for breach of the obligation of good faith by a surety. It would seem that the Arizona courts would follow the general rule that the liability of the surety is limited to the express terms of the surety contract. Id. There does not appear to be any cases, from any jurisdiction, where a court has implied a cause of action giving an obligee a claim in tort when a surety has allegedly breached an obligation of good faith. Even California law, which Amfac finds so persuasive, holds that a surety cannot be held beyond the express terms of the contract. See *United States Leasing Corporation v. duPont, 69 Cal.2d 275, 70 Cal.Rptr. 393, 444 P.2d 65, 71 (1968).*

Amfac relies on Arizona and California case law which it argues gives an insured under a liability insurance contract the right [**25] to sue in tort when the insurer has breached its duty of good faith under the contract of insurance. Although this authority may have some persuasive effect, it does not persuade us that the principle should be extended by us to surety contracts.

This court, faced with Arizona case law indicating a reluctance to expand a surety's liability, and no case law from any other jurisdiction making a surety liable in tort to an obligee in this situation, will not make such a departure itself. We therefore affirm the district court's dismissal of Amfac's eighth claim for relief insofar as it attempts to state a claim sounding in tort.

The judgment of the district court is AFFIRMED.

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